

Fiscal Note

Fiscal Services Division



SF 303 – Military Retirement Pay Tax Exemption (LSB 2169SV.2)
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Fiscal Note Version – As passed by the Senate

Description

Senate File 303 as passed by the Senate, exempts all military retirement income from the State income tax, retroactive to January 1, 2014. This Bill excludes military retirement income from the calculation of the alternate tax and the calculation of the tax filing threshold.

Background

Iowa currently exempts the first \$6,000 (single) and \$12,000 (married) in qualified retirement income from the State income tax (applies to traditional pensions, annuities, and distributions from Individual Retirement Accounts (IRA) and deferred compensation plans). To qualify, the taxpayer or the taxpayer's spouse must be 55 years of age or older, disabled, or a surviving spouse or a survivor having an insurable interest in an individual that would have qualified for the exemption during that tax year.

Assumptions

- According to federal Defense Finance and Accounting Services data, pension income paid to 11,472 lowans in 2012 totaled \$252.8 million.
- The Department of Revenue income tax micro model projects 7,765 income tax returns will experience an income tax reduction due to the changes in this Bill.
- The difference between the number of lowans receiving military pensions (11,472) and the number of tax returns benefiting from this Bill (7,765) is explained by:
 - Taxpayers exempt from Iowa income tax due to the current Iowa income tax filing thresholds.
 - Tax situations where Iowa's current \$6,000/\$12,000 pension exemption fully covers an existing military pension.
 - Taxpayers with pension income, including military pension income, in excess of \$6,000/\$12,000, but for other reasons have zero or negative Iowa income tax liability.
 - Disability-related pensions that are already exempt from State income tax.
 - Married taxpayers where both spouses are receiving military retirement income. In those instances, a tax return represents two military pensioners.
- Military pension payments were assumed to grow with inflation as forecasted by Moody's Analytics in November 2013.
- The tax liability impact was estimated for the 7,765 Iowa tax returns currently paying income tax on all or a portion of their military retirement income using the Department of Revenue's income tax micro model. The micro model uses tax return information to account for nontaxable military pension benefits, includes interactions with the current pension exclusion, alternate tax, and filing thresholds, and reflects an estimated increase in the number of military retirees living in the State over time.
- The tax change is retroactive to January 1, 2014. For tax year 2014, 30.0% of the revenue reduction is assumed to impact FY 2014 and 70.0% to impact FY 2015. For tax year 2015, 40.0% impacts FY 2015 and 60.0% FY 2016.

- For those school districts that have a local option income surtax in place, the annual yield from that surtax depends on the Iowa income tax owed by Iowa taxpayers living within the school district. Law changes that impact Iowa income tax, with the exception of changes impacting refundable tax credits, also change the amount of revenue generated by the local option income surtax.

Fiscal Impact

The following table provides the projected income tax reduction by tax year, along with the revenue impact on the State General Fund and on the local option income surtax for schools.

SF 303 - Military Retirement Income Income Tax Reduction and State/Local Revenue Reduction In millions				
Tax Year	Income Tax Reduction	Fiscal Year	General Fund Revenue Reduction	Local Option Income Surtax Reduction
TY 2014	\$ -8.1	FY 2014	\$ -2.4	\$ 0.0
TY 2015	-8.4	FY 2015	-9.0	-0.3
TY 2016	-8.7	FY 2016	-9.4	-0.3
TY 2017	-9.1	FY 2017	-8.9	-0.3
TY 2018	-9.6	FY 2018	-9.4	-0.3

Sources

Department of Revenue Individual Income Tax Micro Model
Defense Finance and Accounting Services (DFAS)
Moody's Analytics

/s/ Holly M. Lyons

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The fiscal note for this bill was prepared pursuant to [Joint Rule 17](#) and the Iowa Code. Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.
